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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 8/17/84 Number: ------------ Due By: ------------

Subject: Minutes of the Cabinet Council on Economic Affairs July 17, 26 & 30, 1984

	Action	FYI
ALL CABINET MEMBERS	☐	☑
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
Baker	☐	☑
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☑	☐
Chapman	☐	☑
Executive Secretary for:		
CCCT	☐	☑
CCEA	☐	☑
CCFA	☐	☑
CCHR	☐	☑
CCLP	☐	☑
CCMA	☐	☑
CCNRE	☐	☑

REMARKS: Attached for your information are the minutes of the following meetings of the Cabinet Council on Economic Affairs:

July 17, 1984
July 26, 1984
July 30, 1984

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RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-

☐ Don Clarey ☑ Tom Gibson ☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs

L-300B

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

July 17, 1984
2:00 p.m.
Cabinet Room

Attendees: The President, the Vice President, Messrs. Regan, Weinberger, Smith, Clark, Block, Baldrige, Donovan, Hodel, Meese, Stockman, Brock, Svahn, Abrams, Niskanen, Darman, Fuller, McFarlane, Oglesby, Speakes, Verstandig, Porter, Wright, Schneider, Ballentine, Baroody, Donatelli, Entin, Cicconi, Cribb, Gibson, Hobbs, Rhodes, and Li, and Ms. Dole.

Secretary Regan introduced the meeting by noting that it was the 250th meeting of the Cabinet Council on Economic Affairs. Excluding Christmas and August when the Council typically met less frequently, the Council has averaged almost two meetings per week. The Council has considered 456 agenda items, an average of almost two agenda items per meeting.

The Council has created forty-eight interagency working groups since 1981. The Department of the Treasury has chaired slightly less than one-third of them; over two-thirds of the working groups have been chaired by other departments and agencies.

1. Economic Outlook

Secretary Regan presented a report on the economic outlook. The discomfort or misery index (the sum of unemployment and inflation) in 1984 declined by about 40 percent from the levels reached in 1980. This decline has resulted from strong real economic growth combined with declining inflation. Real gross national product (GNP) growth increased from -0.8 percent in 1980 to 6.2 percent in 1983 and 7.7 percent thus far in 1984. The GNP deflator declined from 10.2 percent in 1980 to 4.1 percent in 1983 and 3.3 percent in 1984.

The unemployment rate rose from 7.2 percent in December 1980 to 10.7 percent in December 1982, but has steadily declined to 7.1 percent in June 1984. The employment ratio reached 60.0 percent in June 1984, which is the highest rate since 1979. The number of people employed in June 1984 was 107.4 million.

Annual real compensation growth increased from -3.2 percent in 1979 and -1.6 percent in 1980 to 1.4 percent in 1983 and

1.0 percent in 1984. Real wage growth has been even stronger on an after-tax basis.

There are no basic changes in the mid-session review of the budget. The Administration will simply update the figures for the stronger than expected first-half performance. The Administration is expecting the second half of 1984 to be strong, although not quite as strong as the first half.

The current expansion is significantly healthier than past expansions. Some observers have criticized the Administration for relying on a consumer-led recovery because of the high real interest rates. In fact, business investment has led the expansion, rising at a 14 percent annual rate since the fourth quarter in 1982, compared with an average 7.3 percent annual rate in previous expansions.

The prospect for inflation is favorable. The price of gold remains low relative to its price in the late 1970's, industrial commodity prices have been soft in recent months, spot oil prices are generally below contract prices despite difficulties in the Persian Gulf, and the producer price index for finished goods has experienced no change in the last three months.

The Federal Reserve Board is not expected to change significantly its current money growth targets. While the Federal Reserve is concerned about any future outbreak of inflation, it is also worried about the impact of interest rates on developing countries.

The Council discussion focused on monetary policy and inflation prospects. Council members cited the experience of past Administrations that prematurely declared victory over inflation, only to experience high inflation later. The President noted that the unemployment rate has declined to a level close to what economists consider the "natural" rate of unemployment.

2. Budget Outlook

Mr. Stockman presented an overview of the budget outlook, covering recent projections for spending and revenues during fiscal years 1984 and 1985-1989. He reviewed the budget projection changes due to revised economic assumptions for economic growth, interest rates, unemployment, and other variables. He reviewed the impact on the budget outlook of recent legislative action on the deficit downpayment plan.

The Council discussed the impact of interest rates on the public debt and budget deficits. It also discussed the effect of higher than expected economic growth on the budget deficit.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

July 26, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Pierce, Brock, Niskanen, Porter, Wright, Brown, Ford, Lyng, Ballentine, Fitzwater, Gibson, Healey, McMinn, Neal, O'Keefe, Platt, Riggs, and Li, Ms. Risque.

1. Implementation of the Job Training Partnership Act

Mr. O'Keefe presented a report reviewing implementation of the Job Training Partnership Act (JTPA).

A basic purpose of JTPA is to increase employment and earnings of individuals participating in the program. There are three major components of the program: (1) a basic training program primarily for the economically disadvantaged; (2) the Summer Youth Employment Program; and (3) the dislocated worker program.

Critics of JTPA have questioned whether private employers would actively participate in the program, and whether States would give the program high priority.

Today, 11,000 employers are serving on local private industry councils, all States have moved promptly and effectively to assume their new block grant responsibilities, and the Federal Government has reduced its regulatory activity and staff levels involved in administering JTPA.

The basic training program in JTPA served 435,000 people in its first six months of operation (October 1983 to March 1984). Of the program enrollees, 95 percent were economically disadvantaged, 47 percent were minority, 42 percent had received public assistance, 53 percent were female, 55 percent were high school graduates, 27 percent were high school dropouts, and 38 percent were youth under 21 years of age. About half of the enrollees were assigned to classroom training, 12 percent to on-the-job training, 27 percent received job search assistance, and 15 percent received other forms of assistance. Between 70 and 75 percent of the funds were spent on training. Of the 435,000 participants, 115,000 have already finished the program. Of the 115,000 individuals completing the program, 73 percent found regular employment, more than twice the percentage under the Comprehensive Employment and Training Act.

The dislocated worker program provides training, job search, and relocation assistance to workers displaced by technology, imports, or other factors. The States determine the eligibility for the program. In the first six months of operation, the dislocated worker program served 65,000 individuals.

The Council discussed the duration of the training program. While the training may last as long as 9 months, it typically lasts 4-5 months.

The Council also discussed criticisms of the program that it is "creaming," that is, training those individuals who would likely have found a job anyway. The Council noted that CETA did not adequately prepare its participants for regular, unsubsidized employment, the Job Corps program also trains primarily economically disadvantaged individuals, and the JTPA has indeed focused on those individuals who are disadvantaged.

The Council reviewed the dislocated worker program. While the Congress quickly appropriated funds for the program, States have not rushed to spend the funds before the programs could be established carefully. The States have focused most of their initial spending on job search assistance.

Council members expressed concern about Summer Youth Employment Program spending being skewed away from some urban areas. Congress may seek to add new funds to the program for urban areas. Council members noted that JTPA allocates funds according to a formula based on the total rate of unemployment. The Department of Labor will continue to analyze how the formula could be improved.

The Council asked the Department of Labor to prepare a one-page paper comparing the performance of CETA and that of JTPA.

2. <u>Report of the Working Group on Federal Credit Policy</u>

Mr. Ballentine presented a report from the Working Group on Federal Credit Policy reviewing recent initiatives launched by the Federal National Mortgage Association (FNMA). These initiatives include:

1. Issuing mortgage-backed securities (MBSs) backed by adjustable rate and graduated payment mortgages;

2. A proposal to develop a retail market for MBSs by lowering the minimum certificate denomination from $25,000 to $1,000 for certain pools of mortgage loans;

3. Discussions with the Department of Housing and Urban Development concerning the possibility of cancelling Farmers Home Administration (FmHA) mortgage insurance on FNMA's holdings of FmHA-insured, single-family mortgages that are at least 12 years old; and

4. A program to use FNMA's Federal agency status to enhance the credit-worthiness of tax-exempt, multifamily housing bonds.

Individually, these initiatives present little cause for concern; yet collectively, they represent a further expansion of FNMA's ties to the Federal Government.

Partially as a result of the Deficit Reduction Act eliminating the exemption from Federal income taxes of the Federal Home Loan Mortgage Corporation (FHLMC), the Federal Home Loan Bank Board (FHLBB) has begun a study of methods to privatize FHLMC. For example, the FHLBB is considering transferring ownership of FHLMC stock to saving and loan institutions. While some describe this proposal as privatization, it would not sever all the FHLMC's ties to the Federal Government.

The Council discussed when it would be most appropriate to press for privatization. Council members noted that FNMA is in a difficult financial position now, given current interest rates.

3. <u>Continental Illinois</u>

Secretary Regan outlined the key features of the Continental Illinois arrangement. The Federal Deposit Insurance Corporation will inject funds through the holding company. The Federal Reserve Board will provide the bank full access to borrow funds. The old board will be asked to resign.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

July 30, 1984
10:00 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Stockman, Niskanen, Porter, Wallis, Abrams, Ford, Lesher, Lighthizer, Ballentine, Gibson, Johnson, Neal, Nelson, Platt, and Li, Ms. McLaughlin and Ms. Risque.

1. Report of the Working Group on the Economic Impact of Demographic Shifts

Mr. Jones presented a report from the Working Group on the Economic Impact of Demographic Shifts, which reviewed the effects of changing immigration patterns on the economy. There are between 450,000 and 550,000 legal immigrants entering the U.S. each year. This figure includes about 120,000 refugees. Legal immigration has amounted to about 15 percent of total U.S. population growth since 1980.

Of the legal immigrants entering the U.S., about 30 percent eventually depart because of cultural, economic, or other reasons. Emigration of former immigrants amounts to about 100,000 people per year.

Estimates of the flow of undocumented immigrants are necessarily uncertain. The Immigration and Naturalization Service (INS) estimates that it apprehends about one out of two or three undocumented immigrants. Since the INS apprehends about one million undocumented immigrants each year, the number of people entering the U.S. illegally is probably 2-3 million per year. Large numbers of these leave the U.S. every year. Estimates of the stock of undocumented immigrants range from 2-12 million.

The 1980 census profile suggests that illegal immigrants probably have the following characteristics. They tend to be young with about 18 percent under age 15 and 49 percent between ages 15-29. Two-thirds are Hispanic with Mexico the dominant source. Sixty percent of the adults are male. About half locate in California and the rest are concentrated in Texas, Florida, New York, and Illinois.

Some observers argue that immigration causes strains in the provision of social services, displacement of domestic workers, and social integration problems. Other observers argue that immigration results in higher consumption, more jobs, augmentation of the labor supply, alleviation of social security strains (since many illegal immigrants pay taxes but do not collect benefits), and filling of jobs that others are reluctant to accept.

The Council discussion focused on the impact of immigration on employment and social services. Some anecdotal evidence suggests that illegal immigrants take jobs which pay wages higher than the minimum wage. States with high immigration levels generally have unemployment rates below the national average. The evidence on the use of social service by illegal immigrants is unclear as well.

The Council approved establishing an interagency working group including the Immigration and Naturalization Service, the Departments of State, the Treasury, Commerce, and Labor, the Office of Management and Budget, The Council of Economic Advisers, and the Office of Policy Development, to analyze more accurately the economic impacts of immigration.

2. <u>Saving: The U.S. Experience</u>

Mr. Jones presented a paper analyzing historical U.S. saving rates, explaining different saving measures, and comparing U.S. and other countries' saving rates.

Between 1955 and 1983, gross saving averaged 15.9 percent of gross national product (GNP). Aside from economic downturns when gross saving declines relative to GNP, this ratio has remained stable. During 1982 and 1983, however, gross saving fell to 13.2 percent of GNP but recovered to 15.1 percent by the first quarter of 1984.

During most of the postwar period, gross saving exceeded gross private domestic investment, reflecting U.S. investment abroad. Since 1982, the pattern has reversed, reflecting large capital inflows.

Two measures of gross saving are used: (1) the difference between total income and current outlays, the National Income and Product Accounts (NIPA) method; or (2) the increase in assets less the increase in liabilities, the Flow of Funds (FOF) method. The major difference between the two measures is that NIPA defines all consumer spending as current consumption, while FOF classifies consumer durables as investment and depreciation of the stock of durables as consumption. Other differences include the treatment of public life insurance and retirement funds and Special Drawing Rights.

Both gross saving and net saving (gross saving less depreciation) relative to GNP have fallen below long-term average levels. Net saving declined to 1.7 percent of GNP in 1982 and 1983, compared with the average 6.8 percent rate from 1955 to 1981. Major factors causing this decline include: the 1981-1982 recession, government budget deficits, increased net foreign investment, and larger depreciation charges because of shifts in investment to shorter-lived assets.

Among selected Organization for Economic Cooperation and Development (OECD) countries, the U.S. has had the lowest ratio of national saving to GNP. Even after adjusting the U.S. saving rate to include, for example, social security pension funds, consumer durable purchases, education expenditures, and research and development spending, the U.S. still has one of the lowest saving rates.

There are two general approaches to increasing saving: (1) fundamental tax reform which would focus on providing equal incentives for various types of saving and eliminating opportunities for arbitrage by treating saving and borrowing equally; and (2) reduction of the Federal budget deficit.

The Council discussion focused on how State and local government contributions to pension funds are treated in the saving measures. In addition, the discussion focused on the effect that a revenue increase would have on gross saving, both in the short- and long-term.

Secretary Regan requested that this issue be discussed further in a future meeting.